The Continuing Appeal of 1031 Exchanges

Even though the capital gains tax has been reduced, there may still be a tax bite involved when you sell property, not to mention the sticky issue of depreciation recapture. That is one reason why the IRS Section 1031 exchange has appealed to many owners and investors. And, a 2002 IRS ruling pertaining to Tenancy in Common (TIC), allowing individuals to own a fractional interest in a 1031 property, such as an office building, has created more interest in this kind of transaction.

Brenden Faber, president of Santa Ana, California-based First American Exchange Co., said that TIC transactions are likely to become much more prevalent, "since the IRS has tacitly given guidelines as to how to do them." Asked if he thought that TIC transactions could be likened to a new form of syndication, Faber said yes.

The tax-deferred exchange business is more active on the West Coast than on the East Coast at the moment, Faber pointed out. Among the key advantages (other than the obvious tax deferral advantage) of 1031 exchanges, he noted, are the leverage a seller can get from the tax savings; the opportunity to consolidate holdings into fewer properties that are more manageable; or the ability to purchase a larger piece of property.

But, he advised, "The exchange process is very detail-oriented. Know who you're dealing with. Get competent tax advice. Remember that the days can go very quickly when you have to identify a like-kind property and close on it."

Tax-deferred exchanges can work for all types of property – office, industrial, retail and even vacant ground. Property that a developer may be holding just to sell, however, cannot be exchanged. Nor can property owned by partnerships. And don't try this at home, kids. Seriously. You cannot do an exchange on your primary residence.

For a primer on 1031 exchanges, First American Exchange has obligingly made one available on its Web site, which is www.firstexchange.com.